

STATE OF CALIFORNIA

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PAYROLL LETTER # 01-004  
CIVIL SERVICE ONLY

TO: All Agencies in the Uniform State Payroll System

FROM: RALPH ZENTNER, Acting Chief  
Personnel/Payroll Services Division

RE: FRINGE BENEFIT/EMPLOYEE BUSINESS EXPENSE REPORTING COMPLIANCE  
PROJECT

This Payroll Letter provides information regarding the 2000 Fringe Benefit/Employee Business Expense FB/EBE Compliance Project and related compliance updates.

#### FB/EBE COMPLIANCE REQUIREMENTS

Employers must satisfy three tax requirements: 1) Report all taxable FB/EBEs provided employees as outlined in the Payroll Procedures Manual (PPM) Section I 120-175; 2) Report all FB/EBEs based on "constructive receipt". Taxable and reportable FB/EBEs must be reported when the employee is paid and/or receives the "value/benefit". All FB/EBEs must be reported to this office by the 10th of the month following the month that the employee received the benefit. For example, the value of an employee's Personal Use of a State Vehicle in January 2001, must be reported by February 10th 2001; and 3) Report all FB/EBE's accurately.

#### OVERVIEW

Two thousand (2000) marked the fifth year of the State's efforts to secure and maintain federal and state employment tax compliance requirements. The 2000 project results continue previous performance trends-increased compliance and a general reduction in targeted noncompliance performance. For example, the number of departments reporting within the constructive receipt requirement and doing so monthly increased 25% over 1999 levels. Departmental reporting accuracy was excellent--less than 5% error rate. Overall 115 agencies reported more in 2000 than 1999.

Unfortunately, non-compliance problems tied to comprehensive and timely reporting continue. For example, regularly provided taxable benefits such as Meals for Less than 24 Hour Travel Without Lodging, Electronic Devices and value of Personal Use of State Vehicles were not reported or reported late. Moving

Expenses and Moving Mileage are routinely reported late, as departments inappropriately delay reporting until calendar year end versus "constructive receipt". Many departments do not use the Payroll Input Process (PIP); PIP was only used by 101 of 324 departments.

#### 2000 IMPROVEMENTS

The following highlights compliance improvements achieved this past year:

- Taxable wage reporting increased by \$8.4 million; a 25% increase over 1999 and a 52% increase since the initial, 1996 compliance project.
- The number of reporting departments increased from 207 in 1999 to 268 (out of 324).
- The number of non reporting departments "from 1996 to present" dropped for the fifth consecutive year. In 1996, 90 departments did not report --in 2000, 32 had not reported during the last 5 years.
- Over 77% of departments now initially report in the first calendar quarter; a 20% improvement over 1999's 57%.
- Twenty-two departments implemented PIP reporting and the total amount of PIP reported benefits rose from \$18.9 million to \$26.1 million.
- Twenty-nine departments reported FB/EBEs for the first time. Of the 16 new reporting entities established in 2000, 11 of 16 reported benefits and their initial reporting was consistent with "constructive receipt" standards. Five of the sixteen did not provide FB/EBEs to their staff.
- New benefits were reported by 139 out of 324 departments.
- Sixty-six percent of agencies audited by the Bureau of State Audits in 1999/2000 improved their FB/EBE compliance performance.

#### COMPLIANCE ISSUES

The following represent compliance problems wherein sustained corrective measures are required:

- Approximately 57 departments annually do not report FB/EBEs; 32 have never reported and 25 reported in at least 1 of the previous 5 years. Given the nature, scope and types of benefits available, non reporting remains an open compliance issue.
- Sixty-five departments did not initially report taxable benefits until after the 1st quarter: 23 reported in the 2nd quarter, 25 reported in the 3rd quarter and 11 in the fourth quarter. Audit findings indicate in many cases, benefits were reported late.
- Departments continue to experience problems capturing taxable "value based" benefits. Unlike travel claims wherein paid benefits are readily apparent, reporting benefit values for Personal Use of State Vehicles, Electronic Devices, etc. require greater interaction within departmental reporting processes. Accounting and Payroll operations cannot report tax liabilities unless those authorizing benefits report

these taxable values.

- Departments under utilize PIP as a reporting tool. Although PIP reporting amounts rose 7% in 2000, an additional \$8.2 million could have been via PIP. Only 22 departments used PIP to report the 11 new benefits established in 2000. Only 101 agencies have used PIP; however, 180 agencies provide benefits which can be paid via PIP.

#### FEDERAL DEVELOPMENTS

The Internal Revenue Service's (IRS) reorganization is nearly complete. State and local governments now fall under the IRS's new Tax Exempt/Government Entities Division (TE/GE). This division develops the overall compliance strategies and goals to enhance/achieve FB/EBE compliance. The division likewise develops, implements and evaluates governmental examinations (audits) and procedures.

Under the new reorganization, the Public Employer Tax Compliance (PETC) project resides within TE/GE. TE/GE also possesses the data necessary to readily profile, target and aggressively address public sector employer performance and compliance issues. For example, the State of Massachusetts was the first state profiled in 2000 by TE/GE wherein non-compliant. Employment Tax practices produced a \$31 million assessment. Clearly, the IRS is well positioned to effectively address program issues and service its clients via the streamlined customer clustered alignment.

#### BUREAU OF STATE AUDITS (BSA)

Special BSA audits, conducted in late 1999 through mid 2000, underscore the need for ongoing FB/EBE program audits. These audits revealed unique departmental problems and program oversights as noted above. The audits also identified recurring problems including: staffing issues; belief that tax regulations do not apply to departments; inadequate training; and absence of departmental controls. To sustain and maintain voluntary compliance, ongoing FB/EBE program audits are required.

#### ANNUAL COMPLIANCE ACTIVITIES

Plans for the State Controllers Office 2001 FB/EBE Compliance Project are underway. A Payroll Letter outlining the start of the annual compliance project will be released this spring. Meanwhile, agencies should review FB/EBE business practices and ensure that all FB/EBE compliance objectives are satisfied.

#### CONTACTS

If you require additional information, use the following contacts for assistance:

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